Woman C.P.A.

Volume 31 | Issue 1 Article 2

1-1969

Philanthropy or Misanthropy

Beulah Luther

PHILANTHROPY OR MISANTHROPY

The author contrasts philanthropy and misanthropy and describes some of the responsibilities of the accountant in properly reporting to the public on the financial activities of nonprofit organizations.

Beulah Luther
Dallas, Texas

Charity has been with us since the beginning of time—Christ taught it when He was on earth—and the Treasury Department recognized private philanthropy in 1917 when it first allowed an income tax deduction for an individual's gifts to charitable organizations. Since that time, particularly during the post World War II years, the growth of nonprofit organizations has been phenomenal.

The Nonprofit Organization

What is a nonprofit organization? It is a legal entity, incorporated or organized, for philanthropic purposes. It has a governing board, usually a board of directors or trustees, which functions much as the board of directors of a corporation. It is exempt from federal taxation, but is required to file an information return with Internal Revenue Service. Many of the large organizations publish annual reports but, unfortunately, the Information Return No. 990-A is the only report made by many groups.

There are many types of nonprofit organizations such as churches, schools, hospitals, welfare organizations, fraternal organizations, and private foundations. The Subcommittee No. 1, Select Committee on Small Business of the House of Representatives of the United States has had estimates ranging up to as many as 50,000 private foundations and charitable trusts in the United States. The Russell Sage Foundation estimates that about 18,000 nonprofit entities are presently active, and of these only 6,803 have assets of $200,000 or make grants of $10,000 or more annually. Nonprofit organizations are often difficult to identify because the names of the organizations are not necessarily descriptive.

No one actually knows the number of active organizations, inactive organizations with undistributed assets, or how many of the listed organizations no longer exist. However, the Treasury Department now requires detailed information on the information returns so that the organizations may be properly classified. Data processing will be of great assistance in determining the number, type, etc., of nonprofit organizations.

Private philanthropic organizations can possess important characteristics which government lacks. They may be multi-centered, free of administrative superstructure, subject to the control of highly qualified individuals with widely diversified views and interests. They can initiate thought and action, experiment with new and untried endeavors, and act quickly and flexibly. They play a vital part in our economy, and it is not the intent of the Treasury Department to destroy private philanthropy—only misanthropy.

Philanthropy—Big Business

Philanthropy is big business. It includes not only churches, schools, hospitals, welfare organizations such as Red Cross, United Funds, but also private foundations. For example, The Ford Foundation has assets valued at more than $3 billion; the Rockefeller Foundation, $850 million; Duke Endowment, $690 million. In 1966 the Ford Foundation disbursed approximately $354 million for grants and projects. In 1965 the Rockefeller Foundation disbursed approximately $28 million and Duke Endowment almost $17 million.

BEULAH LUTHER is Assistant Secretary and Controller of The Southwestern Legal Foundation, Dallas, Texas, an educational institution, a position she was elected to in 1960 after six years in the "non-profit" field.

Mrs. Luther is a native Texan who studied at East Texas University of Commerce. Her knowledge of accounting for non-profit organizations is based upon experience, research and study.

Mrs. Luther is a past president of the Dallas Chapter of the American Society of Women Accountants and of the Park Cities Toastmistress Club and a member of the Business and Professional Women's Club of Dallas.

The receipts of 575 private foundations under investigation by the Congressional Subcommittee (1), for the years 1961 through 1964, were almost 30% higher than the combined net earnings, after taxes, of the 50 largest banks in the United States.

These are large institutions and are not typical of the majority or average private foundation, but even the medium size foundations receive and disburse large sums of money. For example, during the year 1964, 100 medium to medium-large private foundations in Texas disbursed almost $12 million for grants and projects.

Accountants for Nonprofits

Who is doing the accounting for these organizations? The large operating organizations such as hospitals and schools have their own accounting departments. Some organizations are administered by banks, some company-sponsored foundations are administered by the company which created it, and the administration includes accounting. And, apparently, some small private foundations do not utilize the services of an accountant. The creator or principal donor records the receipts and disbursements and files the information tax return.

The author mailed a questionnaire to 100 medium to medium-large foundations in the State of Texas, and found, on the basis of replies received, that two-thirds of their accountants are men, that two-thirds are over 45 years of age, and that none were below the age of 25. About one-half are not accountants and less than one-fourth are CPA's. Financial transactions are recorded by hand by 99% of those who replied, and the accounting of more than two-thirds is combined with other duties. Only about one-half had any formal training in accounting. The others relied on research and "trial and error".

Approximately one-half of the organizations had independent audits annually, but only one-fourth published their financial statements. Nonprofit organizations are accountable to the public, but, even though a copy of each information return filed with Internal Revenue Service is placed on display, copies are not readily available to the average person.

Philanthropy

Traditionally, the administrative costs of a nonprofit organization are very small. The combined expense of the Ford, Rockefeller and Duke organizations amounted to less than 3% of the total disbursed for projects and grants. Government could not begin to operate that economically. Many of the organizations have no operating expense at all. The cost is absorbed by the donors or others. This is philanthropy.

Misanthropy

There is misanthropy, too. During the past few years a congressional subcommittee, under the chairmanship of Congressman Wright Patman of Texas, has investigated the activities of 575 large private foundations. The Subcommittee reports that, on the whole, the record of foundation disbursements is one of solid accomplishment, but that serious abuses have been uncovered among a few.

The case of The Public Health Foundation for Cancer and Blood Pressure Research, Inc. (page 10, Subcommittee's report), provides a classic example of what can happen. The Foundation was under the control of James H. Rand, Jr., former president and chairman of Remington-Rand (now Sperry-Rand), Internal Revenue Service claimed.

IRS further claimed that Mr. Rand, who was in the 80-90% tax bracket, made contributions to the Foundation, benefited from the deduction on his individual tax return, and still retained control of the funds in the Foundation. Also, IRS claims that the Foundation did not expend the funds for true charitable purposes, that payments were made to Mr. Rand's social friends and associates, and that he utilized funds for his own personal benefit.

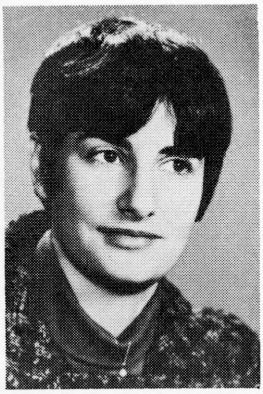
One of the charges against the Foundation was that in 1958, at the suggestion of James H. Rand, Jr., it loaned a Stuart, Florida, resident the sum of $30,000 on a mortgage to build a new home. No payments were due on the principal of the mortgage for 30 years, and the loan carried a 3-½% interest rate per year.

Accounting Responsibility

With the privileges enjoyed by tax-exempt organizations goes the responsibility of not only carrying out the stated purposes but also of reporting the activities to the public. The accountant is in the key position to detect misrepresentation and fraud. He is responsible for reporting the receipt and disbursement of funds, as well as reporting the *source* of funds received and the *purpose* for which they were expended.

First, in accounting for a nonprofit organization, the accountant must know where he is going before he starts. What is the purpose of the organization? What activities will it undertake? What will be the source of its funds?

In addition, he must be fully aware of prohibited transactions. The Public Health Foundation for Cancer and Blood Pressure



GAIL AYN LEVIN

GOLD MEDAL WINNER

A highlight of the Annual Meeting of The American Institute of Certified Public Accountants in Washington, D. C. in October, 1968 was the Institute's presentation of the Elijah Watt Sells Gold Medal to 22 year old Gail Ayn Levin of Gary, Indiana who received the highest grade among the 17,820 candidates throughout the United States on the November, 1967 CPA Examination. The second woman in the history of the accounting profession to earn this honor, she also won the gold medal in Illinois for the highest examination grade of all the candidates in that state.

Miss Levin is presently attending Law School at Duke University, on a leave of absence from Arthur Andersen & Co., Chicago, Illinois, where she worked on the tax staff of that national accounting firm after graduation from the University of Michigan.

After receiving her A.B. degree in Economics (magna cum laude) in June, 1966, Miss Levin received her M.B.A. (cum laude) in August, 1967 and graduated first in a class of 102. During her college career she was selected for membership in Alpha Lambda Delta (Freshman Women Honorary), Phi Beta Kappa, Beta Gamma Sigma (Business Honorary), Beta Alpha Psi (Accounting Honorary) and Circle Residence Halls Leadership Honorary.

Honors commenced early for Miss Levin. Despite being active on the debate team and a member of the band in high school (she plays oboe), she also found time to become a National Merit Finalist, a member of the National Honor Society, and a winner of silver medals in the Indiana University achievements tests in algebra and comprehensive mathematics. In addition, she was the Valedictorian of her class and its Outstanding Girl Graduate (Elk's Award).

Research, Inc., among other things, was accused of: Lending its funds without adequate security, purchasing securities or other property for more than adequate consideration, selling securities for less than adequate consideration, and, an unreasonable accumulation of income (from $579,000 in 1954 to $10.2 million in 1962, $9.6 million in 8 years).

Income Sources

Nonprofit organizations have two principal sources of income: Operating income, such as payment for products or services rendered, and income from investments and contributions and bequests, either cash or property.

A third source of income which has come under the attack by the Congressional Subcommittee is the gain or loss from sale of assets. Gain on sale of assets is not operating income. It is an addition to the principal, or fund balance, of the fund which owned the asset and is not considered in determining the amount of accumulated income. The Congressional Subcommittee has taken the position that gain on sale of assets should be treated as ordinary income and distributed—not added to principal or corpus. Some Foundations have been accused of speculating in the stock market. However, according to the Subcommittee's report, far more was gained than was lost in security transactions. If foundations are allowed to continue exercising prudence in protecting their capital, the end result will be more money available for charitable purposes.

Operating income should, of course, be reduced first by the cost of operations in accordance with commercial accounting principles, and should be accounted for in separate accounts.

Donor-Restricted Funds

Gifts without purpose are seldom received by any nonprofit organization. A gift for the general purposes of the organization may be used in any way the organization wishes. However, a gift for a specific project or purpose, a "donor-restricted" gift, may be used only for the purpose stipulated.

"Donor-restricted" gifts require stewardship reporting. Not only must the funds or gift be used for the purpose designated, but the accounting to the public should reflect the receipt of the gift, the restriction on it, and a report of expenditures for the purpose specified. All such gifts should be accounted for either separately or, where more than one contribution is received for one specific purpose, by group; that is, by fund or fund group.

In purchasing an asset, particularly for less than adequate consideration, the seller and purchaser may agree that the asset will be used or maintained for specific purposes. Mr. Rand and his Foundation entered into such an agreement.

James H. Rand, Jr., sold his 41-acre estate and furnishings to The Public Health Foundation for Cancer and Blood Pressure Research, Inc., for $231,462.50, supposedly, IRS claimed, for research purposes and to house visiting scientists. In turn, he negotiated a lease for one bedroom in the house for the sum of $2,400 per year. The Foundation paid the salaries of four household employees and all household and maintenance expenses. IRS claimed that the house was not used for research and did not house visiting scientists, that it was used exclusively by Mr. Rand.

Each Fund A Separate Entity

Each restricted fund should be a balanced fund. The balance sheet should reflect the specific assets of the fund, the liabilities and the unexpended balance. Fund balances should be noted as either appropriated or unappropriated. Also, the financial statement should reflect the receipts and disbursements in each individual fund. In other words, each fund is treated as if it were a separate entity.

There are degrees of restrictions. For example, an educational institution may have several divisions or centers. A contribution may be received for the general purposes of the organization and, in such case, the organization has the right to designate the contribution for use in the work of any or all of the centers, or it may designate the contribution to be used for general administrative expense, grants, or other projects.

Or, a gift may be designated for use by one particular center. Such a contribution may be used only for the activities of that center and may not be used for any other center. However, the restriction is general and the organization has the right to use the gift for any part of the activities of the designated center.

Or, a restriction may be more specific. It may be for scholarships for the center's programs. In this instance, a restricted fund exists within a restricted fund.

A donor's restriction may be extended to income. For example, the donor may specify that the principal of his gift not be expended. Only the income may be used and that income for a special purpose such as a scholarship, the maintenance of a building, or for some other worthy purpose.

Self-Imposed Restrictions

There is another type of restriction—a self-imposed restriction. The governing board of the organization has the right to impose restrictions on unrestricted general funds. These restrictions do not have the binding quality of donor-restricted gifts, since the governing board may remove the restriction at any time. These self-imposed restrictions should be revealed in the financial statement, separate and apart from donor-restricted gifts and from each other. They, too, should be balanced funds and reflect specific assets, liabilities and unexpended fund balances.

The governing board may designate funds as endowment and specify that only the income be expended. Such funds should be designated as "funds functioning as endowment". Often, donor-restricted endowment funds are mingled with "funds functioning as endowment". The financial statement may combine the two, properly noted, but adequate records for each type should be maintained.

Another type of self-imposed restriction is the appropriation. The governing board may make an appropriation of unrestricted funds to a specified individual or agency for a specific purpose. If the appropriation consists merely of payment of a stipulated amount, it more nearly resembles an accounts payable item and should be treated as such. However, funds should be transferred from the "unappropriated" balance to the "appropriated" balance and the liability recorded.

There will be no assets or liabilities, and as payments are made the appropriation will be reduced to zero. The financial statement should reveal such encumbered funds and the liquidation of the obligation. Some organizations treat appropriations as charges against income at the time the money is appropriated rather than when it is paid. Such practice should be mentioned either in a note to the financial statement or in the auditor's opinion.

Expenditures

In accounting for nonprofit organizations, there are four general types of expenditures: Fund raising expense, general administrative expense, grants, and project expenditures.

(Continued on page 13)

man resources under the general direction of Professor R. Lee Brummet. Others are similarly interested in this subject.

EFFECT ON THE BALANCE SHEET

Another important area of research is in connection with what effect income measurement has on the balance sheet.

Does this process of income measurement have such effects on balance sheet presentation that we are increasingly destroying its significance?

We realize that many figures on the balance sheet are simply items that are not included in net income measurement. This, for example, is true of the undepreciated value of depreciable assets. Their depreciated values are by definition by-products of depreciation accounting.

Similarly, deferred income tax is a liability that results from the tax allocation problem. Professor Sprouse of Stanford University goes so far as to say that some of these items are not even liabilities. In fact, he doesn't know what to call them and therefore he designates them to be accounting "what-you-may-call-its."[2]

THE BASIC PURPOSE OF ACCOUNTING

An additional area for research is, what actually is the purpose of accounting. In the first place, to whom are we reporting, and what is the related effect of reporting to various individuals? The same goes for accounting analysis—for whom is it made, and what sort of analysis is useful for the various users? Again comes the question of the relationship of techniques to concepts.

Then we are not entirely clear as to what is the relationship of accounting to a given business organization.

Does one organization require one sort of accounting and another organization require a different sort of accounting? (For example, what is appropriate accounting for a nonprofit organization?) Here again, we are unclear and we may be on the verge of assuming that instead of a report that gives "fair" presentation what we need is not an omnibus report, but special reports for various purposes.

SYSTEMS ANALYSIS AND DESIGN

Another important area of research in accounting is on systems analysis and design. The accountant largely has neglected his important position in accounting systems in that he has not kept up with modern improvements that have come about in the computer through the increased use of mathematics, and the increased development in equipment, technology and general scientific development. Therefore, much additional effort is required before we will achieve the proper level of the accountant's status in systems and design in the modern corporation.

PHILANTHROPY OR MISANTHROPY

(Continued from page 8)

Fund raising and general administrative expenses are self-explanatory and should be accounted for in separate items on the financial statements.

Grants are payments to others, usually for specific purposes. It is not uncommon for a nonprofit organization to engage in philanthropy outside the walls of its own organization. In fact, many private foundations are dedicated to the support of churches, welfare organizations, educational institutions, and other worthy charitable organizations. Such grants are not normal administrative or overhead expense incurred in the operation of the organization and should be accounted for separately.

Project expenditures have characteristics of both administrative expense and grants. For example, a research project will involve administrative and overhead expense, yet the result of the project will inure to the public good. Again, the project expenditure is not a normal administrative expense, and each project should be accounted for separately.

Mr. Rand, too, was interested in a project—a research project. IRS claimed that The Public Health Foundation for Cancer and Blood Pressure Research, Inc., constructed a research laboratory at a total cost of $159,186.68. The principal purpose of the laboratory was to grow hydroponic vegetables, such as tomatoes, green beans, etc., free of toxic insecticides and high in nutritional value. The hydroponic farm was operated with several employees at considerable expense. This was a project expenditure, but IRS further claimed that the vegetables were for the private use of James H. Rand, Jr., and a few of his friends, and that the laboratory was not built for and could not be used in the public interest.

In order for the financial reports to clearly reflect the activities of the organization, expenditures must be grouped as outlined above. Totals of the familiar "salaries," "supplies," "postage", do not indicate whether or not the

(Concluded on page 18)

[2] Robert T. Sprouse, "Accounting for What-You-May-Call-Its," *The Journal of Accountancy*, Vol. 122, No. 4, October 1966, pp. 45-53.

PHILANTHROPY OR MISANTHROPY
(Continued from page 13)

organization is carrying out its purposes. However, a schedule of such expenditures should be attached to the financial statement.

Inter-Fund Transactions

It is not uncommon for a nonprofit organization having more than one fund to have inter-fund transactions; that is, one fund will receive contributions from another fund, and will make grants to still another fund. It takes little imagination to see what can happen to the final result of the organization's combined operations.

The Public Health Foundation for Cancer and Blood Pressure Research, Inc., was not the only foundation which James H. Rand, Jr., controlled, IRS claimed. The Public Health Foundation made a medical research grant of $750,000 to Colonial Research Institute. About 6 weeks later, Colonial Research Institute made a grant of $750,000 to International Research Foundation. Immediately thereafter, International Research Foundation made grants totaling $650,000 to three individuals for "advancement of human welfare". The three individuals were not accountable to anyone for the distribution of the income or corpus and had the right to name successor managers. The three individuals were friends and associates of Mr. Rand who served him with little or no compensation. IRS claimed that the transactions had nothing to do with the exempt purposes set forth in the foundation's charter. However, it is an example of how the activities of an organization can be inflated. It's like "the music goes 'round and 'round—and it comes out here." Both receipts and disbursements are overstated.

Inter-fund transactions should be recorded in the individual funds as though they were transactions with outside organizations. However, in the combined statement of receipts and expenditures inter-fund transactions should be eliminated and listed as a separate item. This method of reporting reveals the actual source of funds received by the various funds and the purpose for which they were expended.

Inter-fund receivables and payables should be liquidated at intervals so that one fund will not be financing the activities of another fund. However, there is no necessity for inter-fund receivables and payables where cash is credited to the appropriate fund immediately upon receipt but deposited to common bank accounts. Cash is co-mingled and the consolidation of cash enables the organization to keep the surplus over current needs invested.

Inter-fund transfer of assets other than cash should be at fair market value. For example, a security held by the General Operating Fund which has increased in value should be transferred at the market value at the time of transfer, and the gain recorded in the General Operating Fund. Accordingly, the fund receiving the asset should record it at the increased value.

The cost basis of assets held by nonprofit organizations is the actual cost of assets purchased, or the market value on the date received of gifts of property. However, the balance sheet should reflect the market value of all assets, either parenthetically in the main body of the statement, or in a note to the statement. Internal Revenue Service has required this information on the 990-A Information Returns since 1964.

The Accountant's Vital Role

Accounting for a nonprofit organization carries with it great responsibilities—not only to the organization itself, but to the public. And there is a gap between charitable organizations and the public. The general public is not aware of the existence of a great number of these charitable institutions, or of what they are doing for the public good. It is not aware of the wealth of the organizations or of their capabilities. Reports of the activities of all nonprofit organizations should be readily available to the public—their accomplishments should be publicized.

As philanthropy plays a vital role in our economy, so the accountant plays a vital role in philanthropy. There is a need for accountants, particularly young women, with a knowledge of accounting for nonprofit organizations. In addition, all accountants should have some knowledge of this specialized field of accounting. Accounting for a nonprofit organization can be extremely complex, and the accounting profession must keep pace with the growing needs of philanthropy.

SOURCES

Tax-exempt Foundations and Charitable Trusts: Their Impact on our Economy (Fourth Installment). Subcommittee Chairman's report to Subcommittee No. 1, Select Committee on Small Business, House of Representatives, 89th Congress, December 21, 1966.

Treasury Department Report on Private Foundations. Committee on Ways and Means, U.S. House of Representatives, February 2, 1965.

The Foundation Directory, Edition 3 (1967), published by Russell Sage Foundation.